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STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE
MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Proposed Increase in Electric Rates of Interstate Power and Light Company	**FINDINGS OF FACT, CONCLUSIONS, and RECOMMENDED ORDER**

The above-entitled matter came on for evidentiary hearing before Administrative Law Judge Allan W. Klein on November 18 and 19, 2003 in St. Paul, Minnesota. Public hearings were held in Stewartville and Albert Lea on November 5, 2003. The record in this matter closed on January 12, 2004.

Michael Bradley, Attorney at Law, Moss & Barnett, P.A., 4800 Wells Fargo Center, 90 South Seventh Street, Minneapolis, MN 55402, appeared for Interstate Power and Light Company (Interstate, IPL, or the Company).

Ginny Zeller and Linda S. Jensen, Assistant Attorneys General, NCL Tower, Suite 1400, 445 Minnesota Street, St. Paul, Minnesota 55101, appeared for the Minnesota Department of Commerce (Department).

Susan Mackenzie, Stuart Mitchell, and Louis Sickmann, Rate Analysts, 121 Seventh Place East, Suite 350, St. Paul, Minnesota, appeared on behalf of the Staff of the Minnesota Public Utilities Commission (Commission).

NOTICE

Notice is hereby given that, pursuant to Minn. Stat. § 14.61, and the Rules of Practice of the Minnesota Public Utilities Commission ("Commission") and the Office of Administrative Hearings, exceptions to this Report, if any, by any party adversely affected must be filed according to the schedule which the Commission will announce. Exceptions must be specific and stated and numbered separately. Proposed Findings of Fact, Conclusions and Order should be included, and copies thereof shall be served upon all parties. Oral argument before a majority of the Commission will be permitted to all parties adversely affected by the Administrative Law Judge's recommendation who request such argument. Such request must accompany the filed exceptions or reply (if any), and an original and 15 copies of each document should be filed with the Commission.

The Commission will make the final determination of the matter after the expiration of the period for filing exceptions as set forth above, or after oral argument, if such is requested and had in the matter.

Further notice is hereby given that the Commission may, at its own discretion, accept or reject the Administrative Law Judge's recommendation and that said recommendation has no legal effect unless expressly adopted by the Commission as its final order.

STATEMENT OF ISSUES

IPL and the Department, either through investigation and responsive testimony, or through a Settlement, a copy of which is in the record that accompanies this Report, have resolved all but the following issues.

- Schedule 10 costs charged by MISO: What level of documentation of benefits is needed to allow IPL to recover FERC approved MISO operational costs?

- Nuclear regulatory study costs: Should IPL be allowed to recover nuclear study costs incurred when complying with NRC safety tests if those costs should have been recovered prior to the plant benefiting Minnesota rate-payers?

- Incentive compensation plan costs: Should IPL be allowed to recover incentive compensation costs using a tracker mechanism if it incurred no incentive costs in the test year? Is an incentive mechanism that contains an earnings-per-share provision contrary to ratepayer interests?

- OPEB and pension expenses: Will rates reflect the appropriate level of expenses if IPL's 2003 expense increase is used in establishing rates?

- The amount of the accumulated depreciation reserve for the Enterprise Resource Planning Project ("ERP"): Should the accumulated depreciation reserve be set at 6.5 months or 12 months?

- Decommissioning Cost Recovery: The parties agree on the proper amount of decommissioning costs to include in current rates. Should the Commission also determine the comparative rights of Minnesota and Iowa ratepayers other than as needed to set rates in this proceeding?

- Non-peak declining block rates: should the existing non-peak residential and Farm Phased declining block rate differential be reduced or eliminated?

- Stored Heat service: Should this service be available to new customers?

In addition to the above contested issues, IPL and the Department have submitted joint proposed findings of fact with respect to those issues outside the Settlement Agreement. Those findings are included in this Report, following the findings on the disputed issues.

Based upon all the proceedings herein, the Administrative Law Judge makes the following:

FINDINGS OF FACT

Jurisdictional-Procedural Background

1. On May 16, 2003, IPL filed a Petition with the Commission, under Minn. Stat. § 216B.16, for an increase in electric rates of $4,973,766 (an approximately 8.0 percent increase over current rates). IPL also filed a Petition for Interim Rates in the amount of $2,858,158 (a 4.6 percent increase).

2. On July 17, 2003, the Commission issued an Order accepting the filing and suspending the proposed rate increase until the Commission has determined the reasonableness of the proposed rates or the expiration of the ten-month statutory period (whichever comes first) under Minn. Stat. § 216B.16(2) (2002).

3. On July 17, 2003, the Commission issued a Notice and Order for Hearing, directing that a contested case hearing be convened to determine the reasonableness of the rate changes proposed by IPL.

4. On August 7, 2003, a pre-hearing conference was held before Administrative Law Judge Kathleen Sheehy in St. Paul, MN. Petitions to Intervene were filed by and granted to the DOC, and Office of Attorney General.

5. On July 17, 2003, the Commission issued an Order setting interim rates, authorizing IPL to collect $ 1,982,727 in additional annual revenues effective July 18, 2003. IPL is collecting interim rates subject to refund if the interim rates are in excess of the final rates determined by the Commission.

Summary of Public Comments

6. Public hearings were held at Stewartville and Albert Lea where members of the public were given the opportunity to testify. Judge Kathleen Sheehy presided over those meeting. A total of 3 members of the public attended, two of whom testified that IPL's economic development efforts are very important to their communities.

7. Five written comments were received from affected ratepayers. They all expressed opposition to any increase in rates

Description of the Company

8. IPL was formed as a result of two mergers. First, Interstate Power Company ("IPC"), IES Utilities Inc. ("IES") and Wisconsin Power and Light Company ("WPL") became wholly-owned utility operating subsidiaries of the newly formed Interstate Energy Corporation effective April 1998. On January 1, 2002, IPC and IES were merged to form IPL. IPL and WPL are wholly-owned subsidiaries of Alliant Energy, previously known as Interstate Energy Corporation. Alliant Energy's headquarters are located in Madison, Wisconsin. IPL distributes natural gas and generates, transmits and distributes electricity in Minnesota, Iowa and Illinois. The Company serves approximately 40,000 electric customers in Minnesota. IPL's Minnesota electric service territory encompasses approximately 11,100 square miles, including 2,368 miles of electric transmission lines and 2,185 miles of electric distribution lines. IPL operates 271 substations in Minnesota. The Company's electric energy portfolio for its Minnesota customers includes base load plants (fueled by either coal, natural gas or nuclear power), combustion turbines, diesel generators, renewable energy, and purchased power.[1] The Company's last rate increase in Minnesota was granted in 1996.[2]

EXPENSE ADJUSTMENT ISSUES

MISO Expenses

9. The Department opposed the recovery of $228,965 of the Midwest Independent Transmission System Operator ("MISO") Schedule 10 administrative costs and $4,437 of non-firm wheeling costs. The Company agreed in rebuttal testimony with the DOC that the MISO congestion management/redispatch costs in the amount of $9,516 should be disallowed from test-year expense recovery.[3] The Company, while asserting entitlement to recover the non-firm wheeling costs, elected to defend only its right to recover the MISO Schedule 10 costs.

10. The only *documented and quantified* savings attributable to the Company's participation in MISO is $26,167, which represents Minnesota's share of the Company's prior payments to MAIN (Mid America Interconnected Network) for services that were assumed by MISO.[4] The Department recommends disallowance of the remainder of the MISO schedule 10 costs on the grounds that the Company has not shown quantitative benefits resulting from MISO's actions.[5] The Company asserts that: a) it would be too soon to develop a meaningful cost/benefit analysis because MISO is still in its start-up mode; b) a quantitative analysis is not realistically feasible because it is impossible to separate out the impact of MISO from the impact of other market factors; c) even without a quantitative (dollar) cost benefit analysis, IPL is able to demonstrate that MISO provides important and meaningful benefits; and d) MISO costs are a cost of doing business imposed on IPL by Federal Energy Regulatory Commission ("FERC").

11. FERC Order 2000 strongly encouraged all public utilities that own, operate or control interstate transmission facilities to file a proposal for participation in an RTO or alternatively, to explain efforts made to join an RTO along with reasons for not participating in an RTO and a description of any plans for eventual or actual RTO participation. While the Department has characterized joining an RTO as "voluntary", FERC expects public utilities to join an RTO unless they can show good cause for not

joining.[6] After IPL indicated it would join MISO, FERC specifically required IPL to join MISO as part of the approval of the merger that created IPL.[7]

12. As a member of MISO, IPL is charged a proportionate share of MISO operational costs through a FERC approved Cost Adder contained in MISO's Open Access Transmission Tariff ("OATT").

13. FERC Order 453 found the Schedule 10 rate adder contained in MISO's OATT to be just and reasonable. FERC in its Order on Remand, p. 24, stated: "This reflects the simple reality that Midwest ISO provides all transmission service and must be compensated as would any transmission provider." But FERC Order 453-A declined to allow utilities to directly pass through Schedule 10 costs. Instead, utilities may only recover MISO Schedule 10 costs if they first demonstrate that they have a revenue deficiency in a rate proceeding, and if a utility has agreed to a rate freeze, it should not be exempted from that rate freeze agreement by FERC.

14. In its July 2, 2003 Order Denying Rehearing and Clarifying Prior Order, p. 10, FERC expressed its expectation that, with the exception of a utility having entered into a rate freeze, utilities would be allowed by state utility commissions to recover Schedule 10 costs as a cost of doing business, as opposed to being unable to recover the ISO Cost Adder as an additional charge without addressing other rate issues.

15. When the Commission authorized IPL to join MISO in its May 9, 2002 ORDER AUTHORIZING TRANSFER WITH CONDITIONS, Docket No. E001/PA-01-1505 ("MISO Order"), the Commission imposed a condition that IPL not seek recovery of MISO Schedule 10 operational costs outside of a rate case to prevent the utility from directly flowing through the Schedule 10 expenses as a per kWh charge. At a March 28, 2002 meeting, the Commission indicated that it was not granting a "blank check" to any regulated utility in connection with MISO membership.[8]

16. MISO, acting as a single transmission provider performing security coordination and tariff administration, has undertaken and implemented a wide variety of complex functions that were previously performed by a multitude of entities, and is expected, over time, to result in a more liquid and efficient wholesale energy supply market.[9]

17. MISO has made significant progress in assuming security coordination oversight and tariff administration and is currently working on implementing locational marginal pricing, seams agreements with other transmission entities, and the elimination of through and out transmission rates between MISO and the PJM RTO. These current initiatives are expected to yield both reliability and market benefits.[10]

18. Though MISO's full operational benefits have not yet been realized, MISO is already providing some benefits. MISO eliminates "pancaking" because a single wheeling fee is charged for transmission within the MISO footprint rather than separate "pancaked" charges by each transmission owner. But, as the Department points out, the magnitude of this benefit is not documented in the record. The Company asserts

that having MISO, a single independent entity, overseeing the transmission tariff simplifies and makes uniform the terms and conditions applicable to transmission, and eliminates discriminatory behavior. MISO provides regional coordination of transmission planning, thus, improving reliability and market efficiency. MISO improves management of loopflows, unscheduled transmission flows between adjoining interconnected transmission systems, and seams issues, which include managing and coordinating the transmission grid operation and planning between transmission providers. *Id.* at 6-10. But none of these benefits have been quantitified in the record (except for the $26,167 noted above).

19. MISO is a start-up entity which became operational under its OATT in February 2001. As with any start-up entity, it takes time to develop, mature and yield all expected results. In apparent acknowledgment, Department witness Campbell acknowledged that it may be premature to require IPL to provide a quantitative analysis at this time, reserving the Department's right to request such an analysis in the future.[11]

20. Disallowing costs found by FERC to be reasonable would penalize IPL for complying with federal policy. It would also punish IPL for contributing to the development of a comprehensive regional system and would act to deter participation not only of IPL but also of the other Minnesota utilities. But deferring recovery would avoid these problems, while still giving the Company more time to demonstrate the benefits to Minnesota ratepayers. The Company anticipates filing another rate case in the late summer or fall of 2004. (See, Finding 42).

21. Based upon the foregoing findings, the Administrative Law Judge concludes that recovery of MISO Schedule 10 costs incurred by IPL (except for the $26,167 noted above) should be deferred until a future rate case, when, presumably, IPL will be better able to describe, both qualitatively and quantitatively, the benefits to Minnesota ratepayers.

Regulatory Study Costs

22. IPL now has an ownership interest in the Duane Arnold Nuclear power plant. The plant was built near Cedar Rapids, Iowa, in approximately 1974.[12] IES Utilities of Iowa owned the plant. It has operated, more or less continuously, serving Iowa ratepayers since that time. On January 1, 2002, IES Utilities and Interstate Power Company (the Minnesota utility) merged, and became IPL. Prior to the merger creating IPL in 2002, costs related to Duane Arnold were recovered only from Iowa ratepayers. After the merger, Minnesota's allocated share of the plant's costs is approximately 6 percent. After the Three Mile Island incident, Duane Arnold was ordered by the Nuclear Regulatory Commission ("NRC") to install additional safety equipment. After the safety equipment and systems were installed, the NRC required nuclear plants to undergo extensive testing to make sure that the additional equipment and systems actually

worked. The initial cost of the testing was in excess of $16 million.[13] IPL asserts that the tests have a useful life equal to that of the safety equipment and systems, which is equal to the remaining life of the plant. The Department asserts that the tests were an operating expense and should have been recovered earlier.

23. The applicable FERC Accounting Rule, FERC Account 183, distinguishes between studies that do result in construction, and studies that do not result in construction. In this case, where the studies did not result in construction, the FERC rule gives the Company a choice. The study costs can either be charged to Account 182.2, or they can be charged to an "appropriate operating expense account". The Company elected to capitalize the costs and recover them over the remaining life of the nuclear plant.

24. In a 1993 rate case, the IUB accepted Iowa Power and Light's proposal to capitalize the study costs and include them in rate base.[14] But in deciding the most recent IPL Iowa rate case (2003 rate case), the IUB decided that the remaining unrecovered balance should be recovered over four years, without a return.[15] The Iowa Board reasoned that the costs were more analogous to an operating expense than to a capital expense, and thus changed the recovery period from a long-term one to a shorter, four-year time. The Board explained that it had consistently denied utilities the opportunity to earn a return on operating expenses. The Board also explained that its earlier decision (in the 1993 rate case) was made in the context of "a relatively small amount and the issue was uncontested", and thus the Board afforded it little precedential value for the 2003 decision.

25. Had the Company chosen to treat the study costs as operating expenses in the 1993 rate case, the costs would have already been recovered from the ratepayers who benefited. Even if the Iowa Board had imposed a four-year recovery back in the 1993 case, the costs would have been recovered between 1994 and 1998, well before any Minnesota involvement with the plant (which only began in 2002). IPL's initial filing in this Minnesota rate case proposed the same four-year treatment. As an alternative, IPL proposed recovering the costs over the remaining life of the plant (11 years), with a return on the unrecovered balance.

26. The Administrative law Judge agrees with the Iowa Board and the Department that these costs are more appropriately operating expenses than capital costs. He also agrees with the Department that if the Company had chosen to treat them as operating expenses, or had they been properly classified when first reviewed, they would have been recovered well before the merger brought the plant, and these costs, to Minnesota's jurisdiction. The costs have not benefited Minnesota ratepayers. It is not reasonable to assess Minnesota ratepayers any share of these costs.

Incentive Compensation Plan Expenses.

27. IPL has instituted an incentive compensation program with separate incentive plans for union employees, non-union, non-upper management employees, and a management plan for upper management employees (referred to collectively as

"MICP"). The payment of the incentive compensation is not guaranteed; incentive compensation is not part of the base salary. The incentive compensation payment is tied to performance with respect to a number of pre-established goals, some of which relate to IPL directly, while other relate to IPL's parent, Alliant Energy. One of the factors is the level if Alliant's earnings, which must meet a certain minimum before incentive compensation can be paid to Interstate's employees. During the test year of 2002, Interstate's earnings increased (gaining nearly $7,000,000 in pretax operating income) from 2001. But just the opposite occurred for incentive payments. There was a payment in 2001, but not in 2002. The reason was that Alliant's *overall* earnings were adequate in 2001, but not in 2002. In three out of the last five years, incentive compensation was paid. One of two years in which incentive compensation was not paid coincided with the 2002 test year period.

28. The Department proposes disallowing all incentive compensation expenses ($339,685) because the Company did not pay any incentive compensation in the test year. The department also asserts that the inclusion of a conglomerate-wide earnings-per-share trigger in the compensation plan is contrary to ratepayer interests and should act as a complete bar any recovery. IPL asserts that its incentive compensation plan is beneficial to ratepayers, and that the proposed use of a tracker account should address any remaining concerns over the fact that incentive compensation was not paid in 2002.

29. A test year is used to pick a point in time to evaluate revenues, investments and expenses in setting rates. If an expense is included in the test year that will be eliminated after the test year or if an ongoing new expense is incurred outside the test year, those changes result in adjustments to the test year for "known and measurable changes" because the goal is to set rates that best reflect the utility's actual costs during the period the rates will be in effect. Consequently, what occurred or did not occur during a test year is only the starting point of the ratemaking analysis.

30. Given the uncertainty of incentive payments in the future, IPL proposes to match rates to future expenses by employing a tracker account and to refund any amounts included in rates but not actually paid. This is the same solution imposed by the Commission in NSP's last gas and electric rate case, G-002/GR-92-1186 and E-002/GR-92-1185, to make sure that the rates paid are not higher than the expenses that the rates are intended to cover and prevents a shift of risk from the shareholders to the ratepayers.

> The Commission will therefore require the Company to record all earned but unpaid incentive compensation recoverable in rates under this Order for future return to the ratepayers. This will adequately protect ratepayers' interests and prevent erosion of the test year concept.

ORDER ON RECONSIDERATION, December 30, 1993, pp. 7-8.

31. The Department, in Mr. Lusti's Surrebuttal testimony,[16] asked whether the nonpayment of the incentive compensation was the result of IPL having unusual 2002

test year revenues or expenses. Mr. Hampsher testified that anything unusual about the 2002 test year had been addressed through known and measurable changes. He further testified that the incentive compensation was not paid in 2002 because of the overall poor earnings of Alliant Energy.[17]

32. In its Brief, pp. 15-17, the Department argued that a trigger that prevented payment based on Alliant Energy's earnings-per-share was contrary to ratepayer interests and contrary to prior Commission decisions in NSP's prior 1991 and 1992 rate cases.

33. A fair reading of those decisions indicates that the Commission's primary concern was the possibility that ratepayers might pay for incentive compensation expenses that were not actually incurred while the rates were in effect. The use of a tracker account addressed that concern, and the Commission was not being asked to approve recovery of an incentive compensation program containing such a provision in the 1992 NSP rate cases. The Commission stated that it would address the legitimacy of such a provision if it arose in a future proceeding.

34. IPL must rely on Alliant Energy for its equity needs. IPL needs significant amounts of capital to provide adequate service. If Alliant Energy does not generate reasonable earnings per share, it increases the cost for IPL to obtain capital.[18]

35. There are benefits to IPL (and its ratepayers) that flow from the incentive compensation plan. These include:

- It allows IPL to "attract and retain reliable and well-qualified people."[19]

- IPL decreased its base pay when it instituted its incentive compensation program.[20] A lower base pay lowers the overall employee expenses because a number of benefits are tied to base pay such as the amount of insurance benefits.[21]

- "If IPL did not have a pay plan with the opportunity for an employee to earn variable pay, IPL would need to raise its base pay to make up the difference, from a total cash compensation point of view. It's fair to assume that without the variable pay component in IPL's compensation program, the fixed costs and related compounding costs associated with wages and salaries would increase significantly. . . . [I]t is not preferable to ratepayers for IPL's compensation program to be based solely on base pay – a fixed and recurring cost that would likely be significantly greater than current levels if variable pay opportunities were not present."[22]

- "If a portion of an employee's pay is at risk, or made up of a variable pay opportunity, the employee is much more conscious of the company's financial condition, service and business goals, which translates to our employees being much more conscious of services and costs to ratepayers."[23]

36. Based upon the foregoing findings, the Administrative Law Judge concludes that IPL's incentive compensation plan costs are legitimate, and reasonable. The question, however, is how to treat them for ratemaking purposes, in light of their uncertainty. A logical way would be to allow an average, such as the five-year rolling average proposed by the Company, but subject to a true-up mechanism to protect ratepayers from being overcharged.

OPEB And Pension Expenses

37. IPL included the increase in other post retirement benefit ("OPEB") and pension expenses it actually incurred in 2003 as a known and measurable expense. That amount is a substantial increase over the amount paid in 2002. The Department contends that the amount of increase should be levelized (recovered) over five years because of the concern that 2003 expenses are higher than future actual expenses. The Department's adjustment would lower IPL's requested adjustment of $460,798 to $92,160.[24] The Department notes that the 2004 expenses will be $104,000 lower. IPL concedes that the Department's proposal would be appropriate if IPL expected its rates to be in effect for five or more years. IPL asserts that the rates in this proceeding will be replaced in mid-2004 as a result of a rate case being filed after a 550 MW power plant, which is currently under construction, goes on line. IPL also asserts that to the extent IPL over-recovers its OPEB and pension actual expenses, the excess recovery would be paid into the OPEB and pension account, resulting in lower costs in a future rate proceeding.

38. Pursuant to FASB 87 and 106, IPL is required to recognize the amount of OPEB and pension expenses as they are earned by future retirees. The account contains a significant amount of dedicated funds, which federal law requires be invested, following strict federal guidelines, until actually paid out. The returns earned by those investments help fund current OPEB and pension expenses. When the market is doing well, the current OPEB and pension expense can even be negative. Conversely, when the market is doing poorly, it can cause current expenses to increase significantly.[25] Any ability to manipulate the expenses, by selectively changing the measurement date, is eliminated by FASB 87, which establishes a fixed annual date for determining OPEB and pension expenses.[26]

39. The drivers for the increase in expense for 2003 relate to: 1) poor investment returns as a result of weak financial markets; 2) lower interest rates; and 3) for OPEB, increasing medical costs.[27] These drivers are outside of IPL's control.[28]

40. IPL uses an outside actuarial firm, Towers Perrin, to determine the amount of the current OPEB expenses pursuant to FASB 87 and 106. The Department did not challenge the requirements of FASB 87 for purposes of accounting. Rather, the Department is concerned that rates not be set based on a point of time when those expenses are unusually high.[29]

41. If the current rates are replaced in 2004, IPL would under-recover its actual 2003 expenses by $369,000 and would under-recover its 2004 expenses by $265,000.

The Company states that it will not over-recover its 2004 expenses under its proposed methodology, because those lower expenses would be used to set interim rates in 2004. Further, any over payment by ratepayers would have the effect of lowering future OPEB and pension expenses because excess funds will be put into the OPEB and pension fund.

42. The Company has already commenced construction of a 550 MW generating plant that is expected to be in service by June of 2004.[30] The Company will file another rate case in late summer or the fall to begin recovering the cost of that plant. The Department asserts that there is no certainty that a rate proceeding will occur in 2004 because the Company controls when it will file a rate proceeding and events may intervene that cause the filing not to be made. In support of its point, the Departments points to NSP's Pathfinder experimental nuclear power plant that took seven years to come on line and then was operational for only one hour.

43. A gas fired peaking plant is a different issue from a very early and experimental nuclear power plant. The start up date for a peaker power plant that is already deep into construction and is scheduled to go on line in June is much more certain.

44. The goal should be to match rates with likely future expenses. IPL's proposal comes closer to that goal than the Department's. Even if IPL's rate case is delayed, and the OPEB and pension expenses decreased while the rates remained in effect, IPL would place the excess funds approved by the Commission into the OPEB and pension fund.[31] As a result, any over payment by ratepayers would have the effect of lowering future OPEB and pension expenses.[32]

45. Based on the foregoing findings, the Administrative Law Judge concludes that IPL's actual 2003 OPEB and pension expenses should be recovered in IPL's rates.

Decommissioning Expenses.

46. IPL initially filed to recover approximately $1.4 million for decommissioning expenses related to the Duane Arnold nuclear facility.[33] This was based on a different methodology for estimating the future decommissioning cost than has been approved by the IUB in prior Iowa rate cases. The difference relates to determining the effect of inflation on decommissioning costs. The Company's method projects inflation through the remaining life of the plant. The IUB, on the other hand, projects the cost of inflation during the period that the current rates are likely to be in effect (three years). The Department agrees that IPL's methodology for determining the effect of inflation on the actual cost of decommissioning is appropriate. The Department notes, however, that if the IUB had used IPL's proposed methodology in past rate cases, then Iowa ratepayers would have paid a larger portion of the decommissioning costs, leaving a smaller amount to still be recovered in the future, and a smaller amount to be allocated for recovery from Minnesota ratepayers. The Department believes that Iowa ratepayers have underfunded decommissioning costs during the period that the plant was serving

only Iowa, and that Minnesota ratepayers (who only recently began to benefit from the plant) should not have to contribute to correcting that shortfall.

47. The Department and IPL are in agreement that if the IUB had used IPL's new methodology in past rate cases, the annual decommissioning expense would be reduced by $598,410.[34] IPL has agreed to this adjustment for the purpose of setting rates in this proceeding. Therefore, there exists no dispute between IPL and the Department on the inflation methodology to use in determining decommissioning costs to include in Minnesota rates, and no dispute on the precise amount of decommissioning costs to include in current rates.

48. There is a disagreement, however, as to whether the Minnesota Commission should decide, at this time, whether IPL may revisit this issue in a future Minnesota rate case in the event that the Iowa Board refuses to accept the revised methodology and refuses to allow IPL to recover, from Iowa ratepayers, the amount disallowed here in Minnesota. IPL asks to be allowed to go to the Iowa Board, and ask it to increase the contribution from Iowa ratepayers to reflect the new methodology. If the Iowa Board agrees, then the matter would be closed. But if the Iowa Board disagrees, then IPL desires to reserve the right to present this issue again in its next Minnesota rate case. Over the remaining life of the plant, the additional amount that the Department asserts should be recovered from Iowa ratepayers is approximately $6.6 million (11 years x $598,410).

49. The Department asserts that this is the proper proceeding to determine this issue, and that there is an extensive record supporting the calculation of the decommissioning expense which supports IPL's methodology for determining the effect of inflation. The Administrative Law Judge agrees that the accounting calculation is complex, but the methodology for making the calculation is no longer in dispute, and would not require rearguing. It is the legal issue that is not decided at this point, and which he concludes has not been adequately briefed in this proceeding.

50. The Administrative Law Judge believes that the Commission should defer deciding this issue at this time. There are very substantial legal and policy considerations that deserve more attention than was given them in this proceeding. It is possible that the Iowa Board may agree to IPL's proposal (either in whole or in part), or it is possible that IPL may decide not to pursue the matter here in Minnesota. At this time, IPL's decommissioning costs should be reduced as agreed by both IPL and the Department, and the issue of whether IPL is legally precluded from seeking recovery of those costs in a future Minnesota rate case proceeding should not be determined by the Commission. If the Commission desires to determine the matter at this time, and if the Commission desires a recommendation from the Administrative Law Judge on the appropriate outcome, then the Commission is respectfully requested to remand this issue to the Administrative Law Judge to allow further briefing on this issue.

RATE BASE ADJUSTMENT ISSUE

ERP Accumulated Depreciation Reserve

51. The only disputed rate base issue is whether the investment included in rate base for IPL's Enterprise Resource Planning ("ERP") computer project should be reduced by the average depreciation expense (reducing rate base by the average or 6.5 months' of depreciation expense), as IPL proposes, or whether an end of test-year approach should be used (reducing rate base by 13 months of depreciation expense), as the Department proposes. The Department's adjustment would increase the test year depreciation reserve by $140,360.[35]

52. ERP is a 56.4 million dollar information technology system, providing IPL with a more efficient computer system, which became operational in October 2002, and was fully operational by February 2003.[36] IPL requested that the ERP costs be annualized because ERP was a major capital investment, is known and measurable, and is currently providing service to ratepayers, and the Department agreed to annualize this investment, along with the associated depreciation expenses.[37]

53. The Department perceives that if IPL is allowed to include the full investment in rate base along with a full year of depreciation expense, then the rate base should be reduced by a full amount of that depreciation expense.[38] IPL on the other hand perceives that it is unfair to require the Company to use an average rate base for all other investments and then to use an end of test-year approach for this one investment.[39] The Company filed rate base schedules using an average, rather than an end of test period, rate base. Using an average rather than end of period rate base benefited the ratepayers because IPL's end of period rate base was higher than its average rate base.[40]

54. Because the test year is based on the average rate base, rather than a year end rate base, the amount of the accumulated depreciation reserve is also based on the average amount of depreciation accumulated over a thirteen month period (one half of the amount accumulated at the end of the test year period). This calculation process is used for all investments contained in the rate base. In that manner, there is a match between the average rate base and the average accumulated depreciation reserve.[41]

55. The Department's proposal of reducing rate base by the sum of 13 months of depreciation expense, rather than use the 6.5 month average, singles out the ERP for different treatment than all other investments, and does not match the average rate base to the average depreciation reserve.

56. Using an actual end of test-period expense, December 2002, would only include three months of actual depreciation reserve (October through December), and using February 2003, when ERP became fully operational, would include only 5 months of actual depreciation reserve (October through February). Hampsher, Vol. 1, p. 89; Lusti. Vol. 1, p. 226.

57. Had IPL been able to bring ERP to operational effect as of the beginning of the test year, January 2002, rather than October of 2002, then an average test year period and an average depreciation reserve, equal to 6.5 months, would be appropriate to use. Lusti, Vol. 1, pp. 228-229.

58. There is no reason to treat the Company more harshly than would have occurred had ERP been operational during the entire test year. The investment should be annualized, without a special disallowance rule for the asset, so that the rates going forward reflect this major investment, which requires that 12 months of depreciation expense to be included in expenses, and that the average depreciation reserve of 6.5 months be used to offset that investment.

59. Based on the foregoing findings, the Administrative Law Judge concludes that 6.5 months of accumulated depreciation reserve for the Enterprise Resource Planning Project should be used to set IPL's rates.

RATE DESIGN ISSUES

Non-Peak Declining Block Rate Differentials.

60. IPL's rates currently contain a non-peak/winter declining block rate for residential and single-phase farm service. That means that during non-peak periods, high usage customers pay less, per kwh used, than do low usage customers, so long as the high usage customers exceed a certain minimum usage (1,000 k Wh per month) that makes up the first block. In the first block, all customers pay at the same per kwh rate. But if a user goes into the second block, then the rate in the second block declines. The Department supports either eliminating the differential between the initial and the end block rates or reducing the differential by approximately 50% in this proceeding and eliminating it entirely in IPL's next rate case. Lacey, Ex. 33. The Department asserts that the Company has not provided cost support for the declining block rate, and that the rate increases for heavy use customer can be offset by switching to a rate class that has a separate demand charge and through conservation. Lacy Ex. 34. IPL asserts that its rate is cost based and that the resulting harm cannot be adequately mitigated. Berentsen, Ex. 32, pp. 16-14, and Ex. 1, Sch. F, pp. 1 and 4; Berentsen, Vol. 1, p. 108-110.

61. The Company provided a marginal cost study demonstrating that the incremental cost of serving customers off peak should not include generation costs, the demand costs, because those are caused by the need to meet peak needs. Berentsen, Vol. 1, p. 108. The Company further demonstrated that the declining block rate is in excess of the marginal cost. *Id.* at pp. 109-110. The Company argues that while the revenue requirement is based on embedded cost, incremental cost provides direction on how best to allocate and recover those costs.

62. Whether IPL's off-peak declining block rates should be eliminated was disputed in IPL's last rate case. The Commission's FINDINGS OF FACT

CONCLUSIONS OF LAW AND ORDER, E-001/GR-95-601, April 8, 1996, p. 27, expressly found that the declining block rate was cost based:

> The Commission will approve the Company's proposal in order to be fair to high usage customers, to align costs and rates more accurately, and to recognize in rates the benefits high load factors bring to the system as a whole. . . .
>
> It is undisputed that the flat rates currently paid by high use residential and single phase farm customers over-recover fixed costs, both in absolute terms and in comparison with the fixed costs recovered from average and low use customers. It is also undisputed that high use customers contribute more to keeping system costs low and rates affordable than average and low use customers.
>
> * * *
>
> Rejecting the Company's proposal would mean requiring households and farms with above-average electric service needs to pay a disproportionate share of the fixed costs of the system, despite the disproportionate contributions to system efficiency and the overall affordability of rates.

63. Mr. Lacey agreed that high use customers pay more than their share of fixed costs.[42] Consequently, the Commission's finding that the declining block rate reduces intraclass subsidies remains true. Absent a declining block rate, customers with high usage would pay more than their cost of service.

64. Because IPL's system is designed to meet the peak capacity needs of its customers that occur in the summer season, there is excess capacity during off-peak periods and encouraging usage during those periods merely uses existing capacity and lowers the cost of energy for all users.[43]

65. While the Department has proposed a 9 percent increase in the declining block rate in this rate case with the intent to have the declining block entirely eliminated in IPL's next rate case, eliminating the declining block rate in the next rate case would result in an additional 8 percent rate increase. Because IPL intends to file a rate increase in one year, the entire increase of 17 percent would be applied in the period of two heating seasons.[44]

66. Space heating customers would be among the hardest hit if the declining block were removed. The Department's suggestion that the resulting rate increases could be reduced through conservation did not take into consideration the high cost of having to buy a replacement furnace in order to reduce usage. Nor does it consider the impact on those customers who have already put in state-of-the art furnaces.

67. The Department also suggested the possibility of rate relief if customer would switch to alternative classes with demand charges. For each customer that switched to a demand rate, it would be necessary for the Company to install new demand meters for each customer, increasing the cost of service for all customers as those meters are added to rate base.

68. Finally, it is not reasonable to expect single-phase farm customers to take three-phase service. Single-phase and three-phase services are completely different, with single-phase service at 120 and 240 volts (served on an 8,000 volt line), and a three-phase service at 277 and 480 volts (served by 13,800 volt line). IPL cannot provide three-phase service unless it has a three-phase distribution line in place and the three-phase customer has special three-phase equipment.[45]

69. IPL's existing non-peak declining blocks are cost based, eliminate intraclass subsidies, and avoid the harsh rate impacts that would result from their elimination.

70. Based upon the foregoing findings, the Administrative Law Judge concludes that IPL's rate differential for non-peak declining blocks should not be changed. Declining block rates are not appropriate for all times, but when they are limited to off-peak times and they still recover more than marginal costs, they should be allowed.

Stored Heat Service Access

71. The value of shifting load from on-peak to off-peak is at the base of the other rate design issue which the parties were unable to resolve, which deals with IPL's Stored Heat tariff. IPL has proposed freezing access to its Stored Heat Service to the existing customers. This service offers significant discounts to its users. The proposed non-summer energy rate of the Standard Residential tariff, which is the logical alternative for stored heat customers, is 8.4 cents per k Wh. The Stored Heat energy rate is 3.3 cents per k Wh. The magnitude of this difference is tempered, however, by the fact that if the declining block rate differential remains, then some unknown portion of the switched customer's usage will likely be in the second block, and thus will be at a much lower rate than the 8.4 cents charged for the first block.

72. IPL offers five reasons for this action: First, services should be offered based on cost differences rather than based on the end use to which the energy is given.[46] Second, after 30 years, there are only 26 customers taking the service, which is a tiny fraction of IPL's customers.[47] Third, while IPL is not proposing eliminating the rate in this proceeding, it intends to propose eliminating it in the future, and little would be gained by adding new customers if the service might be eliminated in the near future.[48] Fourth, there is a cost associated with maintaining a separate rate class, and when there are so few customers, those costs are disproportionately high.[49] Fifth, there is little difference in the rates paid by a customer with the service compared to the rates the customer would pay without the service and, as a consequence, limiting access to the service to additional customers would not create a hardship.[50]

73. The Department opposes freezing the rate because it would be discriminatory and because the rate is based on recognition that off-peak time of day usage should have lower costs.

74. Based upon the foregoing findings, the Administrative Law Judge concludes that access to IPL's Stored Heat service may be limited to current customers now taking that service. IPL should be sure that any advertising for stored heat does not mislead potential buyers about the Company's intentions to eliminate this class of service.

RATE OF RETURN

75. The Department and IPL have stipulated that the appropriate rate of return on equity should be 12.22 percent. That is the rate proposed by Department witness Dr. Rakow.[51] It is also within the range proposed by Mr. Hanley and close to his specific recommendation of 12.3 percent.[52] During the evidentiary hearing, Commission staff raised questions whether IPL's size compared to the comparable groups selected by Dr. Rakow and Mr. Hanley justified adjusting the recommended return to reflect a higher financial risk. In addition, Commission staff inquired concerning the justification for including an issuance adjustment (flotation cost) if the stock issuance is by Alliant Energy and not IPL.

76. Mr. Hanley relied on an Ibottson study appended to his testimony (Ex. 2, FJH-1) to demonstrate that size affects risk. Mr. Hanley also testified that the impact of size on cost rate is well recognized in the financial literature, not just the Ibottson study.[53]

77. Staff questioned the methodology used by the Ibottsen study to reach its conclusion that size affects risk. The study reached its conclusion by first taking all NYSE-traded companies, ranking them by market capitalization and then breaking them into ten equally populated groups. Staff did not question that step in the procedure. But after establishing the breakpoints between each group of NYSE companies, the study then assigned all companies on the AMEX and NASDAQ into the groups established by the NYSE breakpoints. Since there are many more mid and small cap companies in the AMEX and NASDAQ groups, this led to a great disparity in the number of companies in the various "deciles". For example, the largest decile had 183 companies in it, while the smallest decile had 2,056 companies in it. But despite the fact that the smallest decile had more than ten times the population of the largest decile, the market capitalization of the smallest decile was only about 72 billion dollars, while the market cap of the largest decile was 7.9 trillion dollars. Staff questioned the validity of a study that compared such wildly disparate groups to determine whether there was a greater return in one group than the other. Staff suggested that it would be more comfortable with comparisons of groups that were roughly equal in population. Mr. Hanley responded to this concern, explaining that adjusting the study deciles in the Ibottson study to reflect an equal number of companies rather than to reflect size differences would have harmed the value of the study because it would have diluted the impact of size, it would have arbitrarily pushed companies into deciles where their size indicates they really

don't belong. *Id.* at p. 11. Mr. Hanley expressed his opinion that in comparing companies that are otherwise comparable, size does matter. Tr. 2 at pp. 18-19.

78. The Administrative Law Judge takes comfort from the fact that Ibottsen Associates is a widely-recognized statistical reporting firm that has a national reputation. He considers it to be in the same general category as Standard & Poor's or Moody's. There is no indication that the report in question was prepared for IPL, or the utility industry, to bolster arguments in rate cases. Instead, it appears that the report in question is part of an almanac-type yearbook that Ibottsen prepares without any particular focus on the utility industry. The Administrative Law Judge understands and shares the concerns of the Staff concerning the methodology used, and thinks the issue is worthy of pursuit in some other forum. But for purposes of this case, the Administrative Law Judge accepts the principal conclusion of the study – that size of a firm is a factor in determining risk and return.

79. Staff also inquired whether IPL was, in fact, smaller than the other companies in Dr. Rakow's comparison group. Staff's questions focused on difference in the number of customers served. Dr. Rakow explained[54] that his analysis of size focused on the relative size of revenues, not customers:

> Revenues for Interstate are about 1.2 billion in 2002, if I remember the number correct. And the average for my comparison group was 4 billion. So its roughly 30 percent, 25 percent. So substantially smaller. And that's where the risk adjustment came from, not from customer count.

80. Dr. Rakow testified that investment risk involves the variability of rates of return. Difference in revenues affect investment risk and smaller companies can be associated with higher risks.[55]

81. Staff also asked whether IPL was less risky today than when rates were last set because IPL has less debt today than it did at the time of that rate case. Dr. Rakow explained that rates of return vary significantly over time, and that it is not appropriate to set rates in 2003 based on the rates set in 1995. Setting current rates of return based on historically authorized returns is not reasonable, as the rates derived from historic risk assessments are not relevant in different rate climates.[56] The Administrative Law Judge agrees with Dr. Rakow.

82. Dr. Rakow explained that an issuance adjustment (flotation cost) was also appropriate because IPL receives its capital from Alliant Energy, which, in turn, incurs issuance costs in order to raise the capital needed by IPL. Especially with capital-intensive subsidiaries in the utility industry, there are going to be issuance costs. The fact that it is Alliant, rather than Interstate, that must pay those costs does not change then fact that they are incurred in order to raise money for the utility operations of IPL. Therefore, the cost of equity for IPL should reflect consideration of Alliant's issuance costs.[57]

83. The Administrative Law Judge concludes that the Parties' joint recommendation to use a rate of return on equity of 12.22 percent is based on substantial evidence in the record, and that the record does not support rejection of either a size or issuance adjustment. He recommends that the stipulated rate of return be accepted.

THE APPLICATION OF MINN. STAT. § 216B.1691, SUBD. (6), TO IPL

84. The Department, in the Direct Testimony of Ms. Campbell, invited IPL to comment on whether the renewable resource requirements imposed on an operator of a nuclear power plant contained in Minn. Laws 2003 Sp. Session Ch. 11, Art. 2 § 3, amending Minn. Stat. § 216B.1691, subd. 6, apply to IPL.[58] Those requirements, if applicable, would have required IPL to meet the same renewable energy requirement as Xcel Energy with respect to wind generation and the purchase of biomass generated energy from a particular biomass project in Northeastern Minnesota, far from IPL's service area. IPL presented the testimony of two witnesses. Mr. Brummond[59] provided evidence that the Legislature believed that the law would apply exclusively to Xcel Energy. Mr. Jordahl[60] provided evidence that applying the same requirements imposed on Xcel Energy on IPL's small Minnesota market would lead to absurd results. The Department then announced that it would not file further testimony on the issue.[61] The record contains no evidence or argument suggesting that the law should apply to IPL. No party chose to cross-examine IPL's witnesses on this issue.

85. IPL's brief includes an analysis of legislative intent based on the evidence presented by Mr. Brummond and Mr. Jordahl, and also based on a transcript of a House floor debate on the legislation.

86. Based on all of the evidence in the record and the legal analysis presented by IPL on this issue, the ALJ concludes that the renewable resource obligations contained in Minn. Laws Sp. Session Ch. 11, Art. 2, § 3, amending Minn. Stat. § 216B.1691 to add Subdivision 6, do not apply to IPL.

STIPULATED OR UNCONTESTED MATTERS

I. RATE DESIGN

A. Miscellaneous rate design issues.

87. The Department and the Company reached agreement on a large number of the Company's rate design proposals through testimony. In its rebuttal testimony, IPL agreed to five of the recommendations made by the Department in direct testimony:

- IPL agreed to the Department's recommended revenue apportionment.[62]
- IPL agreed that in its next rate case

  "…it will not increase each rate component by the same percentage basis as the overall increase in revenue responsibility apportioned

to the class, unless such proposed increases in rate components can be reasonably justified on a cost basis that includes consideration of the demand, energy, and customer cost components for the class."[63]

- IPL agreed to include separate class cost of service data for the Municipal Pumping, Farm, Controlled Water Heat, and Stored Heat rate classes in its next rate case.[64]

- IPL agreed to maintain the current demand charges for the Large General Service class in this proceeding.[65]

- IPL accepted the Department's recommendation to modify the vacant Farm, Municipal Pumping, and General Service rate schedules in a manner consistent with the Department's recommendations to the currently used tariffs within those classes.[66]

B. Meter sockets and meter poles.

88. The Department had concerns about whether IPL's proposal to discontinue the provision of meter sockets and meter poles would harm service quality or provide cost savings.[67] IPL was asked to provide information, in its next rate case, related to its proposal to discontinue its practice of providing an inventory of meter sockets and meter poles.[68]

IPL explained that the Company expects to file a rate case in August 2004 which would not provide enough time to collect the data necessary to document cost savings or whether service quality was impacted.[69] The Company concluded that the proposal to discontinue the provisions of meter sockets and meter poles would result in cost savings because the costs would no longer be placed into the Company's rate base. IPL does not foresee any service quality issues arising from the proposal.[70] Under the modification, the same contractors would still install the facilities but the products would be obtained from a third party, not from IPL. The Company also agreed to provide notice to customers of the policy change for meter poles and meter sockets, along with an accounting in its next rate case of any complaints or concerns expressed by customers as a result of the change.[71]

Based on IPL's response, the Department recommended that the Commission approve IPL's proposal with the requirements that IPL notify customers regarding the change and that the Company provide the requested information in its next rate case (currently expected to be filed in 2004) and in the 2005 and 2006 service quality filings due on April 1 of each year, pursuant to Minnesota Rules 7826, Electric Utility Standards.[72]

C. Line extension policies.

89. The Department asked IPL to demonstrate whether the Company had made an adjustment to its rate base to account for its proposal to modify its line extension policies.[73] The Company explained that the modification to its line extension policies would not decrease the rate base. Instead, because the modification would reduce the length of line extensions, future line extensions would imply a smaller increase in the rate base relative to the current policy.[74] Based on the Company's response to the Department's concerns, the Department agreed that the proposed changes to the Company's line extension policies and meter socket and meter pole provision were reasonable.[75]

D. Stored Heat and Controlled Water Heat Rates.

90. In rebuttal testimony, the Company agreed that the Department's recommended customer charges and percent increases to the Stored Heat and Controlled Water Heat tariffs were reasonable but stated that the recommendations may need to be modified if the Commission approves a revenue requirement that differs from that proposed by the Company.[76]

In surrebuttal testimony, the Department responded that the new percentage increases should be calculated by first apportioning the revenue increases to classes by the class responsibility percentages shown in the Department's direct testimony.[77] The Department also stated that the second step would be to calculate the percentage increase for each class based on the revenue apportioned to classes from the first step compared to existing revenue responsibility of each class.[78]

The Department's surrebuttal statements were unrebutted by IPL.

II. CLASS COST OF SERVICE STUDY (CCOSS)

91. In direct testimony, the Department recommended that the Company classify the demand charges related to Purchase Power (FERC account No. 555) as demand-related costs, rather than the demand/energy basis proposed by the Company.[79] The Company agreed to the Department's recommendation in its rebuttal testimony.[80]

The Department asked the Company to provide a revised CCOSS that would correct for the amount of interruptible discount revenues credited to the Large Power and Light class.[81] The Company's CCOSS included the discounts as $197,332.[82] However, as noted by the Company, the correct amount to be allocated to the class is $227,436.[83] The Company, in rebuttal testimony, included a summary of both IPL's and the Department's revised CCOSS.[84] The Department recommended that the Commission approve the Department's revised CCOSS provided in the Company's rebuttal testimony.[85]

92. The Department recommended that the Commission require the Company, in its next rate case, to classify rate base components and operating expenses by FERC account.[86] The Department noted that the cost classification is one of the three major steps in the cost allocation process (see page 12 of the Electric Utility Cost Allocation Manual, National Association of Regulatory Utility Commissioners, January, 1992). Moreover, the allocation among customer classes is done after the costs have been functionalized and classified.[87] Information provided by FERC account provides

a reasonable basis for the assessment of the classification of the revenue requirements.[88] The Company offered an alternative to the Department's recommendation and stated its willingness to provide, in its next rate case, information that would demonstrate how costs are separated into demand, energy and customer costs. In particular, rate base components and operating expenses would be classified across individual FERC accounts whenever possible. Interstate would aggregate in a reasonable manner the remaining revenue requirement components and provide the classifications.[89] Specifically, the Company stated that:

> IPL is willing to provide, with its initial filing in its next rate case, an analysis that classifies total customer class cost, from the CCOSS, into customer, demand and energy cost categories. In addition, information will be provided that would allow for verification of the classifications. This would include classification of the rate base components and the operating expenses across individual FERC accounts whenever possible. When it is not reasonably possible to provide this information by individual FERC account, IPL would aggregate in a reasonable manner the remaining revenue requirement components and provide the classifications. IPL would provide the FERC accounts included in such aggregated accounts. When it is not reasonably possible to use FERC accounts, IPL would fully describe the consolidated revenue requirement components.

The Department accepted the Company's proposal as a step in the right direction.[90]

III. REVENUE REQUIREMENT ISSUES.

A. Test year interest synchronization.

93. The DOC's recommended interest synchronization adjustment will increase the test-year federal and state income taxes by $1,879 and $583, respectively.[91] Theparties are in agreement that whenever an adjustment is made to the Company's test-year rate base or operating income statement, it is also necessary to make an interest synchronization adjustment.[92] If the DOC proposed revenue requirement is not totally adopted by the ALJ and Commission, the interest synchronization will need to be recalculated.

B. Transmission Firm wheeling transmission component of the DOC Schedule 10 and Wheeling Adjustment to O&M expenses.

94. The Company agreed in rebuttal testimony with the DOC's recommendation that the firm wheeling transmission costs in the amount of $81,664 should be disallowed from test-year expense recovery.[93]

C. MISO congestion management/redispatch costs component of the DOC Schedule 10 and Wheeling Adjustment to O&M expenses.

95. The Company agreed in rebuttal testimony with the DOC that the MISO congestion management/redispatch costs in the amount of $9,516 should be disallowed from test-year expense recovery.[94]

D. Base cost of energy issues

96. On May 19, 2003, Interstate filed a petition for a change in its Base Energy Adjustment Charge in Docket No. E-001/MR-03-768, *In the Matter of Interstate Power and Light Company's Petition for a Change in the Base Energy Adjustment Cost (*the Base Cost Docket). The Company proposed a new base cost of energy of $0.01669 per kWh, to be used in its energy adjustment charge calculation to coincide with the implementation of interim rates in IPL's general rate proceeding.

On July 18, 2003, the Commission issued its Order Setting Base Cost of Energy in the Base Cost Docket. In that Order, the Commission accepted the Company's base cost of energy of $0.01669 in the Base Cost Docket. However, the Commission noted that the Company had proposed a base cost of energy of $0.01711 for interim rates in the rate case, Docket No. E-011/GR-03-767. The Commission determined that the base cost of energy should be set at $0.01669 for both base rates and interim rates in the rate case. The Commission therefore required Interstate to reduce the rate case interim test year energy costs and proposed interim increase by $332,960, to reflect the costs of energy claimed in the base cost petition. The Commission ordered that the base energy cost issue for final rates would be developed in the rate case proceeding. The Commission gave the Company an opportunity to prove in the rate case that its base cost of energy is higher than the $0.01669 ordered for interim rates, with the chance of a true-up at the conclusion of the rate case if necessary.

In direct testimony, the DOC identified three main areas of concern that need to be resolved regarding the base cost of energy: 1) the treatment of off-system revenues, 2) use of average costing of fuel/direct costing of fuel, and 3) the lack of clarity in Volume IV, Informational Requirements Ex. 1, DHB-1, Schedule E, p. 9.[95]

In rebuttal testimony, IPL identified that its revised approach results in a base cost of energy of $0.01573 per kWh.[96] The DOC agreed in surrebuttal testimony with the base cost of energy of $0.01573 per kWh.[97]

The Department agreed in surrebuttal testimony that Interstate's revised average costing method for energy with the total offsetting OSR amount should be accepted.[98]

The Department stated in surrebuttal testimony that IPL will now reflect the total off-system revenue (OSR) as an adjustment in their monthly fuel clause filings.[99] This statement was unrebutted by IPL.

The Department in surrebuttal testimony agreed with the Company's response to DOC Information Request No. 155, where an income statement adjustment increasing test-year revenues to reflect an off-system sales error for Minnesota in the amount of $982,428 was identified.[100]

At hearing Interstate confirmed that it is no longer seeking a true-up of the $332,960 reduction in the rate case interim increase required by the Commission.[101]

The Department and the Company are in agreement on all base cost of energy issues, as identified in the Department's surrebuttal testimony.[102]

E. CIP

97. In rebuttal testimony, the Company agreed with the Department that CIP regulatory review expenses should be recovered in the same manner as other CIP expenses. As a result, $18,476 must be removed from IPL's O&M expenses.[103]

F. Application of the lead/lag study factors to final O&M expenses

98. The Department recommended a reduction in cash working capital as a result of the application of Interstate's lead/lag study factors to the Department's proposed O&M expenses, and that, if the Department's proposed revenue requirement

were not totally adopted by the ALJ and Commission, that the cash working capital recommendation would need to be recalculated.[104] Though the parties continued to contest certain rate case expense issues, and thus the final cash working capital amount, Interstate did not object to the proposed application of lead/lag study factors to final O&M expenses.

IV. OTHER ISSUES

A. Nuclear decommissioning annual reports

99. In rebuttal testimony, the Company agreed with the DOC recommendation requiring IPL to provide an annual report to the Commission regarding FAS 143 regulatory asset, internal funding of decommissioning, and other significant nuclear plant changes or significant events.[105]

B. Marketing expense cost-benefit analysis

100. In rebuttal testimony, the Company agreed with the DOC recommendation requiring IPL to provide a cost-benefit analysis of marketing expense in its next rate case.[106] In agreeing to this condition, the Company assumed that the complexity of such analysis would be in a scale appropriate to the amount being expended by the Company. This statement was unrebutted by the Department. However, if an Interstate request for recovery of marketing costs comes before the Commission in a future rate case, the Commission can address whether the analysis is sufficient to justify the request in the context of that proceeding. This is the ordinary and appropriate treatment of issues in rate case proceedings.

Based upon the foregoing findings, the Administrative Law judge makes the following:

CONCLUSIONS

1. The Minnesota Public Utilities Commission and the Administrative Law Judge have jurisdiction over the subject matter of this proceeding pursuant to Minn. Stat. Ch. 216B and section 14.50.

2. Any of the foregoing Findings which contain material which should be treated as a Conclusion is hereby adopted as a Conclusion.

3. The Company has not demonstrated that it is entitled to immediate recovery of MISO Schedule 10 costs (except for the $26,167 noted in the Findings). Instead, MISO Schedule 10 costs should be deferred until a future rate case to allow the Company to better demonstrate, both qualitatively and quantitatively, the benefits to Minnesota rate payers.

4. The Company has not demonstrated that it is entitled to recover the regulatory study costs incurred prior to Minnesota ratepayers benefiting from the Duane Arnold Nuclear Power Plant.

5. The Company has demonstrated that it is entitled to recover incentive compensation plan expenses, but that such recovery should be based on a five-year rolling average, subject to a true-up mechanism.

6. The Company has demonstrated that it is entitled to recover actual 2003 OPEB (Other Post Retirement Benefit) and pension expenses.

7. There is insufficient argument in the record to support the Department's request for a determination of the final treatment of decommissioning costs. Should the Commission desire to determine the matter at this time, then the issue should be remanded for further briefing.

8. The Company has demonstrated that it is entitled to use a 6.5-month period for accumulated depreciation reserve for the Enterprise Resource Planning Project.

9. The Company has demonstrated that it should be entitled to maintain declining block rates during non-peak periods as it proposes.

10. The Company has demonstrated that it should be allowed to limit the stored heat service to existing customers.

11. The record supports the joint recommendation to use a rate of return on equity of 12.22 percent without further adjustment.

12. Minn. Laws 2003, Sp. Session, Ch. 11, Art. 2, § 3 does not apply to the Company.

13. The record supports all the uncontested matters, and they may be adopted.

Based upon the foregoing Findings and Conclusions, it is the recommendation of the Administrative Law Judge to the Public Utilities Commission that it issue the following:

ORDER

1. IPL is entitled to increase gross annual revenues in accordance with the terms of this Order.

2. Within 30 days of the service date of this Order, the Company shall file with the Commission for its review and approval, and serve on all parties in this proceeding, revised schedules of rates and charges reflecting the revenue requirement for annual periods beginning with the effective date of the new rates, and the rate design decisions contained herein. The Company shall include proposed customer notices explaining the final rates. Parties shall have 14 days to comment.

3. (If the Commission orders an Interim Rate Refund) within 30 days of the service date of this Order, the Company shall file with the Commission for its review and approval, and serve upon all parties in this proceeding, a proposed plan for refunding to all customers, with interest, the revenue collected during the Interim Rate period in excess of the amount authorized herein. Parties shall have 14 days to comment.

Dated this 3rd day of February, 2004.

/s/ ALLAN W. KLEIN

Allan W. Klein

Administrative Law Judge

MEMORANDUM

The Administrative Law Judge had not calculated the precise dollar amount of the decisions rendered above. He believes the Commission staff is better able to calculate the precise dollar amount based upon the Findings and Conclusions.

A.W.K.

[1] Mulford, Ex. 3, pp. 2-3.
[2] MPUC Docket No. E-001/GR-95-601, issued April 8, 1996.

[3] Ex. 26, p. 2; Ex. 36, p. 8.
[4] Guelker, Ex. 26, p.11.
[5] Department Brief, p. 28.
[6] Campbell, Vol. 1, p. 158.
[7] Guelker, Ex. 26, p. 12.
[8] Transcript of March 28, 2002 meeting, appended to Mr. Bradley's January 2, 2004 letter to the ALJ.
[9] Guelker, Ex. 26, pp. 4-5.
[10] *Id.* at pp. 5-6.
[11] Campbell, Ex. 36, p. 11.
[12] Tr. 1, p.66.
[13] Dunn, Vol. 1, pp. 13-14.
[14] Dunn, Tr.1 at pp. 14-15.
[15] See IUB Decision, Campbell, Ex. 36, at NAC-19.
[16] Ex. 39, p. 7.
[17] Tr. 1, p. 56.
[18] Hampsher, Vol. 1, p. 87.
[19] Day, Ex. 22,at p. 3.
[20] *Id.*
[21] *Id.* at p. 4.
[22] *Id.* at pp. 4-5.
[23] *Id.* at p. 5.
[24] Campbell Ex. 35, p. 26.
[25] *See* Campbell, Ex. 36, p. 23.
[26] *See id.* at p. 24.
[27] Hampsher, Ex. 26, p. 32.
[28] *See* Hampsher, Vol. 1, p. 90.
[29] Campbell, Ex. 35, p. 25.
[30] Hampsher, Vol. 1, pp. 53-54..
[31] *Id.* at p. 79.
[32] *Id.* at p. 94.
[33] Mott, Ex. 9, p. 2.
[34] Mott, Ex. 1, Schedule C-1(25).
[35] Lusti Ex. 38, p. 7.
[36] Newell, Ex. 5, p. 2 and 4, and Lusti, Vol. 1, pp. 222-223.
[37] Lusti Ex. 38, pp. 5-6.
[38] Lusti, Ex. 38, p. 7.
[39] Hampsher, Ex. 30, pp. 7-8.
[40] Lusti, Vol. 1, p. 221.
[41] Ex. 30, p. 7.
[42] Vol. 1, pp. 125-26.
[43] Lacey, Vol. 1, p. 125.
[44] Lacey, Vol. 1, pp. 130-31.
[45] Lacey, Vol. 1, p. 133.
[46] Berentsen, Ex. 31, p. 21.
[47] Lacey, Ex. 33, p. 41.
[48] Berentsen, Vol. 1, p. 101.
[49] Berentsen, Ex. 32, pp. 17-18.
[50] Berentsen, Vol. 1, p. 102.
[51] Ex. 12.
[52] Ex. 2.
[53] Vol. 2, p. 19.
[54] *Id.* at pp. 55-57
[55] *Id.*
[56] *Id.* at pp. 59-60.
[57] *Id.* at p. 60.

[58] Ex. 35, at p. 7.
[59] Ex. 7.
[60] Ex. 8.
[61] Ex. 36, at p. 14.
[62] IPL Ex. 32, p. 13
[63] Ex. 32, p. 14..
[64] Ex. 32, p. 16.
[65] Ex. 32, p. 16.
[66] Ex. 32, p. 21.
[67]DOC Ex. 33, p. 43.
[68]Ex. 33, p. 52.
[69]Ex. 32, p. 19.
[70]Ex. 32, p. 20.
[71]Ex. 32, p. 21.
[72] DOC Ex. 34, p. 6.
[73] Ex. 33, p. 52.
[74] Ex. 32, p. 18.
[75] Ex. 34, pp. 5-6.
[76]

IPL Ex. 32, p. 16.
[77]

DOC Ex. 33, ML-2; DOC Ex. 34, p. 4.
[78]

Ex. 34, p. 4
[79]DOC Ex. 14, p. 11.
[80]IPL Ex. 32, p. 11.
[81] Ex. 14, pp. 11-12.
[82] Ex. 14, SO-10.
[83] Ex. 14, SO-2.
[84] Ex. 32, Schedules E-2 and E-2.1.
[85] DOC Ex. 15, p. 3.
[86] Ex. 14, p. 11.
[87] DOC Ex. 15, p. 4.
[88] Ex. 14, p. 8.
[89] Ex. 32, p. 13.
[90] Ex. 15, pp. 4-5.
[91]

Ex. 39, p. 11.
[92]

Ex. 1, CAH-1, Schedule C-1 (30); Ex. 38, p. 16.
[93]

IPL Ex. 26, p. 1; DOC Ex. 35, p.19; DOC Ex. 36, p. 8.
[94]

Ex. 26, p. 2; Ex. 36, p. 8.
[95]

Ex. 35, pp. 15-16.
[96]

IPL Ex. 32, p. 2.
[97]

Ex. 36, p. 16.
[98]

Ex. 32, pp. 3-5; Ex. 36, pp. 15-16.
[99]

Ex. 36, p. 16.
[100]

Ex. 36, p. 16; Ex. 39, DVL-18.
[101]

Tr. Vol. 1, pp. 77-78.
[102]

Ex. 36, pp. 16-17.
[103]

Davis Ex. 13, pp. 6-7; Ex. 30, p. 13; Ex. 39, DBL-18; Tr. Vol. 1, p. 83.
[104]

DOC Ex. 38, p. 8; DOC Ex. 39, p. 9.
[105]

Ex. 35, p. 27; Ex. 30, p. 2.
[106]

Ex. 13, pp. 11-12; Ex. 30, pp. 2-3.